August 7, 2017

CC:PA:LPD:PR (Notice 2017-38)
Room 5205
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Notice 2017-38 and Comments on Temporary Regulations under Section 752—Request to Rescind Bottom-Dollar Payment Obligation Regulations

Dear Sir/Madam:

On behalf of the Investment Program Association (the "***IPA***"), we are writing in response to Notice 2017-38 in which you requested comments on whether certain tax regulations should be rescinded or modified. We strongly believe that Treas. Reg. § 1.752-2T (the "***BDPO Regulations***") issued on October 5, 2016 should be rescinded.[1] Specifically, the BDPO Regulations over-include most commercial arrangements into "bottom-dollar payment obligations" ("***BDPOs***") and contain a one-way anti-abuse rule that, together, add uncertainty and compliance burdens on taxpayers.[2]

The IPA was formed in 1985 to provide effective national leadership for the Portfolio Diversifying Investments ("PDI") industry. The IPA supports individual investor access to a variety of asset classes with low correlation to the traded markets and historically available only to institutional investors, including: Lifecycle Real Estate Investment Trusts ("Lifecycle REITs"), Lifecycle Business Development Companies ("Lifecycle BDCs"), interval funds, energy and equipment leasing programs, and real estate private equity offerings. For over 30 years the IPA has successfully championed the growth and improvement of such products, which have increased in popularity with financial professionals and investors alike. PDI Products have been held in more than three million individual investor accounts. They are a critical component of an effectively balanced investment portfolio and serve an essential capital formation function for the U.S. economy. The mission of the IPA is to advocate for portfolio diversifying investments through education and public awareness.

I. BACKGROUND

On April 21, 2017, President Donald J. Trump issued Executive Order 13789 and directed the Secretary of Treasury to review "significant tax regulations" that burden American taxpayers. In particular, the President ordered the Secretary of Treasury to identify in an interim report all tax regulations that: (1) impose undue burden on taxpayers, (2) add undue complexity to tax law, or (3) exceed the Internal

[1] T.D. 9788 (Oct. 5, 2016).

[2] This comment letter largely derives from Baker & McKenzie LLP's comment letter on Treas. Reg. § 1.752-2T submitted to the Treasury and Internal Revenue Service on January 3, 2017. We would like to thank Baker & McKenzie LLP for its input and efforts.

Revenue Service's (the "***IRS***") statutory authority. The President's ultimate goal is to take necessary action to "reduce the burden existing tax regulations impose on American taxpayers."[3]

Pursuant to Executive Order 13789, the Treasury and the IRS issued Notice 2017-38 and identified the BDPO Regulations as one of eight "significant tax regulations."[4] In Notice 2017-38, the Treasury and IRS requested comments on whether the BDPO Regulations should be rescinded or modified, and if modified, how it should be modified to reduce burdens and complexity.

II. THE BDPO REGULATIONS SHOULD BE RESCINDED

Generally, the rules under Section 752 determine how to allocate partnership debt among partners for purposes of calculating the basis of the partners' partnership interests. The IPA strongly believes that the BDPO Regulations should be rescinded because it adds uncertainty to the rules under Section 752 and compliance burdens on taxpayers.

A. Prior Regulations.

Before the BDPO Regulations, prior regulations provided that partnership debt should be allocated by a partnership to the partners who bear the economic risk of loss ("***EROL***") with respect to such debt. A partner generally bears the EROL for a partnership liability to the extent the partner would be legally obligated to make payments to satisfy the liability out of his or her non-partnership assets if, at such time, the partnership's assets were worthless and all its liabilities were due.[5] This ultimate liability test allocates an otherwise nonrecourse partnership debt to a partner that personally guarantees the debt.

Prior regulations were adopted from a Congressional mandate in response to *Raphan v. United States*,[6] which held that a partner's personal guarantee of the partnership's debt allowed the other partners of the partnership to include the debt into their bases. Congress believed the holding of *Raphan* was "inappropriate,"[7] and directed the Treasury to craft new rules so that a partner's EROL with respect to such debt is considered.[8]

Thus, prior regulations appropriately followed Congressional mandate by using EROL as the metric to determine whether a debt was a recourse liability or a nonrecourse liability. In addition, prior regulations were conceptually consistent and simple, which resulted in predictable results and easier tax compliance.

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[3] Executive Order 13789 § 2(a) (2017).

[4] Notice 2017-38, 2017-30 I.R.B. (Jul. 7, 2017).

[5] Treas. Reg. § 1.752-2(b)(1).

[6] 3 Cl. Ct. 457 (1983).

[7] H.R. Rep. No. 98-432, at 1235 (1984).

[8] H.R. Rep. No. 98-861, at 869 (1984) (providing that the revised rules should be based "largely on the manner in which the partners, and persons related to the partners, share the *economic risk of loss* with respect to partnership debt") (emphasis added).

B. The BDPO Regulations.

Subject to limited exceptions, the BDPO Regulations provide that all guarantees are treated as BDPOs that do not create EROL unless the partner is liable up to the full amount of his or her payment obligation if, and to the extent that, any amount of the partnership debt is not otherwise satisfied. A payment obligation is not a BDPO merely because: (1) there is a maximum amount placed on the partner's payment obligation, (2) a partner's payment obligation is stated as a fixed percentage of the partnership debt to which such obligation relates, or (3) there is a right of proportionate contribution running between partners who are co-obligors with respect to a payment obligation for which each of them is jointly and severally liable. Nonetheless, a BDPO is recognized as creating EROL if a partner has a payment obligation that would be recognized under these new rules but for the effect of an indemnity, reimbursement agreement, or similar arrangement, and, taking into account such indemnity, reimbursement agreement, or similar arrangement, the partner is liable for at least 90% such partner's initial payment obligation.

If a partnership has a BDPO, it must disclose it in its tax return via IRS Form 8275. The BDPO Regulations also contain an anti-abuse rule, which provides that, at the IRS's discretion, the IRS may treat a partner as bearing EROL despite BDPO characterization if there was a principal purpose of avoiding the BDPO Regulations.

C. The BDPO Regulations Add Uncertainty and Compliance Burden on Taxpayers.

As discussed above, the BDPO Regulations ignore the Congressional mandate overruling *Rapahn* that EROL be the metric of how partnership debt is allocated. Instead, by default, the liability will be treated as a nonrecourse liability—even if a partner bears real EROL—unless it falls into a limited category of exceptions.

If the partnership's liability is treated as a nonrecourse liability, the partnership will be required to allocate partnership liabilities based on the partner's share of the profits. This is determined by taking into account all facts and circumstances relating to the economic arrangement of the partners. Determining a partner's interest in partnership profits for Section 752 purposes is an extremely difficult and uncertain task. Consider the following example:

> In a partnership of two equal partners, each contributes $100. Each partner has a different "class" of partnership interest. The Class A partner receives a 10% preferred return on its investment first before any amount is shared among the partners. The Class B partner receives no preferred return. If the partnership earns $50, the Class A partner receives $30 (($100 x 10%) + ($40 x 50%)) and the Class B partner receives $20 ($40 x 50%)—a 60/40 ratio. If the partnership earns $20, the Class A partner receives $15 (($100 x 10%) + ($10 x 50%)) and the Class B partner receives $5 ($10 x 50%)—a 75/25 ratio.

As the example above shows, a partner's interest in partnership profits is not a fixed percentage, but a moving target. Considering that many commercial partnerships have multiple classes of partners and multiple layers of distributions, the determination of a partner's interest in partnership profits is a nebulous and uncertain task. In addition to the new disclosure requirement that adds compliance costs, the BDPO Regulations provide massive uncertainty and a compliance burden to taxpayers.



The one-way anti-abuse rule, applicable only at the discretion of the IRS, provides added uncertainty to this already-uncertain regime. Even if taxpayers carefully structured their transactions to comply with the BDPO Regulations, the IRS can apply this "heads-I-win-tails-you-lose" rule to object to a tax treatment it does not like. As a result, taxpayers would never have any certainty on tax consequences of their transactions, which is detrimental to the integrity of the tax system and opposite of sound tax administration.

III. CONCLUSION

The IPA strongly urges the Treasury and the IRS to rescind the BDPO Regulations because they add uncertainty and compliance burdens to taxpayers. These types of burdens are precisely what Executive Order 13789 aimed to identify and revise in its search for tax regulations that "impose an undue financial burden" and "add undue complexity."[9]

We thank you for your consideration of our above comments.

Respectfully submitted,

Anthony Chereso
President & CEO, Investment Program Association

CC: Daniel F. Cullen
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[9] Executive Order 13789 § 2(a) (2017).